BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

(b) Opinions Below

The opinion of the District Judge (Findings of Fact and Law) appears on pages 298-308 of the record. The opinion of the Circuit Court of Appeals appears on page —— of the record; it is not reported.

(c) Jurisdiction

This is an application for writ of certiorari to a circuit court of appeals, authorized by Sec. 347, T. 28, USCA.

(d) Statement of the Case

The statement in the foregoing petition under the heading "Matters Involved" seems sufficient. Perhaps we should add that the opinions of both lower courts contain erroneous and exaggerating figurges, to which we call attention in case the Court should feel that the degree of supposed benefit the property owners would derive from the proposed plan is important. The opinion of the Circuit Court of Appeals says:

> "If the plan were consumated, the bonded indebtedness of the City would be reduced in excess of $1,000,000."

On the contrary, the plan shows that the total indebtedness is only $981,248.22, and it proposed to refund at 30 per cent of the principal amount (R. 4).

The District Judge speaks of the property-owning bondholders (Palmer, Hobart, and Kirkeby; Kirkeby is president of the Hotel company) as owning 63 per cent of the assessed valuation of the property in the Town (R. 270). These figures are erroneous. The *uncontradicted* evidence of Mrs. Smith, the Town Clerk (R. 74, 172), shows the total assessed valuation of the property in the Town to be $2,502,290.40. She breaks it down as follows:

28 per cent, properties of the Hotel;

19 per cent, vacant properties of the Belleair Estates;

41 per cent, *improved properties,* excluding the Hotel;

12 per cent, vacant properties.

On page 172 she says that Hobart's personal holdings represent $80,070 valuation, and Palmer's $84,860, which are 8 per cent and 8 per cent plus, respectively, of *"the improved property valuation of the Town."* The percentage of these sums to the total assessed valuation is 6½, which, added to the 28 per cent of the Hotel properties, makes 34½ per cent rather than 63, as stated by the Court.

(e) Specifications of Errors

The errors relied on are stated in the petition under the heading "Questions Presented," and we urge each of them.

ARGUMENT

Question 1

IS IT UNFAIR, *per se,* IN A PROCEEDING IN BANKRUPTCY TO COMPOSE THE DEBTS OF A MUNICIPAL CORPORATION, TO REFUND PROPERTY-OWNING BONDHOLDERS' BONDS ON THE SAME BASIS AS THOSE OF NON-PROPERTY-OWNING BONDHOLDERS?

Unless there is an essential unfairness, the lower court erred, because there is no other fact in this case adequate to differentiate the two groups. No fraud or over-reaching on the part of the property-owning bondholders is claimed or found. On the other hand, the District Court finds that their acts have been *"in good faith"* and he ascribes to them *"no ulterior purpose"* (R. 306). The Circuit Court of Appeals also grounded its opinion purely upon *essential differences,* saying that the property-owning bondholders' "consent to the proposal was induced by special interests akin to those of the debtor, to bind others who dealt as creditors only." The lower courts' opinions preclude such seemingly pertinent inquiries as whether the plan is, in fact, fair; whether it proposes that the municipality shall pay all it can pay; whether the *predominating* interests of the property-owning bondholders lie on the side of the debtor or of the creditors. How can the plan be unfair to non-property-owning bondholders when it requires the debtor to pay all it can and give to each bondholder an equal pro rata share? The District Court specifically found that

"Under the evidence in the record, thirty

cents on the dollar represents the City's maximum ability to pay" (R. 307),

and the plan proposes to give all bondholders that amount. Since the property-owning bondholders own a greater percentage of the bonds than they own of the tax-paying property (practically two to one), they receive as bondholders more than they pay as property owners; hence they, like the non-property-owning bondholders, will gain by the highest rate of refunding within the ability of the Town to pay. The interests of the two groups, therefore, are not opposed but identical.

If it be assumed that the reduction of the bonded indebtedness of the Town "would necessarily increase the market value of the real estate in the municipality," as the District Judge says, to what extent would it be increased, and how could such increase be measured for the purpose of equalizing the supposed differential? On the contrary, is it not true that the amount of such increase is altogether speculative; that it cannot possibly be translated into money's worth; that it is an intangible, incapable of being measured; that such increase will be a mere incident of the composition, and will accrue to all property in the Town, and if the non-property-owning bondholders wish to speculate thereon they may do so by acquiring property; that such benefit as may result from an increase in value of the property will accrue to property owners *as such and not to them as bondholders;* and that the whole matter of supposed increase of property value is in the category of vague hopes and possibilities, and cannot be given such

tangible and certain form as to be considered in the asset column of the balance sheet of the Town or constitute a basis for judicial determination.

This Court so reasoned in *Case et al. vs. Los Angeles Lumber Products Co.,* 308 *U. S.* 106, 60 *S. Ct.* 1, where the contention was made that certain stockholders were men of wealth and standing in the community, and that their connection with the reorganized company would, therefore, be of sufficient value to justify a proposed retention of 23 per cent interest to them without putting in new money.

Parallel of Stockholder Creditors

It would seem that if property-owning creditors are in a different class from non-property-owning creditors, under the provision of the Bankruptcy Act applicable to taxing units, stock-owning creditors must, upon the same principle, be classified differently from non-stock-owning creditors in reorganization proceedings under Sec. 77 b. The statutes regulating both proceedings are very similar. The plan must be fair to all parties; creditors must consent in each case, etc. The parallel seems to have been recognized by this Court in the *Avon Park* case, where the Court said it granted the writ of certiorari "in view of the importance of the problems in the administration of the *composition* and *reorganization* provisions of the Act."

The District Court of Delaware, in *re Indiana Central Telephone Co.,* 24 *F. Supp.* 342, considered a plan of reorganization. It was found that the en-

tire capital stock of the debtor was owned by General Telephone Corporation, which also owned 67 per cent of the bonds of the debtor-corporation. The amended plan proposed to give the General Telephone Corporation the power to designate five out of the seven directors of the new company, which was to assume the liabilities of the debtor. The question was raised whether the General Telephone Corporation could participate as a bondholder of the debtor equally with other bondholders, and the Court, after investigating the facts, found and stated that

> "There is absolutely no evidence in the record of fraud, overreaching, misrepresentation or prejudice of any kind on the part of General Telephone Corporation."

The Court then said:

> "Objector contends that General Telephone Corporation occupies a fiduciary relationship with debtor because of its ownership of the common stock of debtor and because of interlocking boards of directors and officers. Assume that relationship for the sake of argument, how can it create any fiduciary relationship between General Telephone Corporation and the holders of bonds of debtor? *Surely a holder of the common stock of a company may also purchase the bonds of that company.*"

The Court held the plan to be fair and approved it.

The Alabama court, in *First National Bank of Birmingham vs. Huddleston,* 195 *So.* 755, says:

> "But as a creditor a stockholder is not rele-

> gated to an inferior status because he is a stockholder" (text 757).

Fletcher's Cyc. Corp., Permanent Edition, Vol. 13, Secs. 5755 and 5756, discusses the general subject quite fully and cites many cases. In Sec. 5756, the author says:

> ". . . it cannot be disputed that a stockholder may become a creditor of the corporation . . . and when he does become a creditor he stands on the same footing and has the same rights as any other creditor."

The bankruptcy statute does not change the general principle of equality of rights between stockholder creditors and non-stockholder creditors, and we submit that the Court ought not where unfairness, in fact, has not been made to appear.

In *Texas Hotel Securities Corp vs. Waco Dev. Co.* (5 *Cir.*), 87 *F.* (2) 395, a creditor acquired notes of the debtor for the specific purpose of preventing confirmation of any plan of reorganization. The Court held that such creditor had a right to do so; that

> "Claims may be transferred in anticipation of bankruptcy or during bankruptcy, and transfer usually does not deprive claim of any of its incidents, and Bankruptcy Act amendment providing for corporate reorganization does not prohibit such transfer nor put transferred claims in a peculiar class," headnote 7.

So in this case the silence of the statute upon the question involved should be given great weight.

It has been many times held that claims of taxing districts may be transferred in anticipation of bankruptcy, and that

> "A taxing agency is not to be denied relief under provision of Bankruptcy Act for composition of indebtedness because preliminary arrangements without which relief could not have been sought were made before institution of proceedings."
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> *In re Corcoran Irrigation District,* 27 *F. Supp.* 322.
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> *In re Merced Irrigation District,* 25 *F. Supp.* 981, affirmed by the 9th Circuit Court of Appeals in *West Coast Life Ins. Co. et al. vs. Merced Irrigation District,* 114 *F.* (2) 654.
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> *Luehrmann et al. v. Drainage District,* (8 *Cir.*), 104 *F.* (2) 696.

Unfairness Further Elucidated

The object of the Municipal Bankruptcy Act is to afford relief to debt-ridden, insolvent cities and towns—relief upon a basis fair to all who are to be affected. Fairness is the pole star set to guide the court. When fairness will be achieved, there are no orbitrary or artificial limits set by the act. It is left for the court to decide from all the facts and circumstances of the particualr case, but where fairness is shown the court is not at liberty to produce unfairness by applying different treatments to different bondholders. The elements of fairness are (1) that the petitioner shall pay or refund upon a basis that represents its reasonable maximum ability; (2) that all creditors be treated alike and not be put in different classes unless different situations so require in order to accomplish fairness.

In this case the Court found that the plan requires the Town to pay all it can pay but, contrary to the recommendation of the Master (R. 55, par. 5), held that the mere fact of property ownership by some creditors requires that they be treated unlike non-property-owning creditors, and suggested that the bonds of one be refunded on the basis of 20 percent and the other 40 (R. 272). The District Judge and the Circuit Court of Appeals held that the mere fact of property ownership required a different treatment. If Hobart, Palmer, and Kirkeby (consenting creditors) owned no property in the Town, then 30 per cent to the objectors would be fair, because they would be getting their part of all the Town can pay. If the bonds owned by Hobart, Palmer, and Kirkeby were owned by any non-property-owning parties, the objectors would get the same 30 cents, and that would be fair. Wherein then is it unfair to objectors to receive the same 30 cents, simply because Palmer, Hobart, and Kirkeby do own property in the Town? Why should Palmer, Hobart, and Kirkeby be discriminated against, simply because they happen to own bonds and property? They have done no wrong, committed no fraud, taken no advantage and, like other bondholders, are getting only 30 percent in new securities. We have suggested that if there be a differential there is no yardstick by which it could be measured; that whatever benefit property in the Town may receive is merely incidental, and accrues to property owners as such and not to bondholders; that the amount of such benefit, or whether any benefit at all, is purely theoretical; that any bondholder can become a property owner if he wishes;

that if property ownership *per se* makes equal treatment of bondholders unfair, then stock ownership in a corporation would make equal treatment unfair, which the authorities negative. Moreover, if property ownership *per se* makes equal participation unfair, then if Hobart and others owned only five percent of the property the Court would have to discriminate against them. If it be conceived that 100 percent property ownership coupled with 25 per cent bond ownership could be used to propose an unfair plan, its unfairness would not be found in the simple fact of unified ownership but in the plan. Some extraneous fact—such, for instance, as in *Kaufman County Imp. Dist. No.* 4, 34 *F. Supp.* 670,, affirmed 116 *F.* (2) 959, where only one-fifth of the money borrowed was used to pay bonds and four-fifths to physically improve the property—would have to appear in order to constitute unfairness. If, conceivably, however, a plan would be unfair to other bondholders simply because of unity of ownership of some bonds and property, the ratio would have to be such as to favor the owner as a taxpayer rather than as a bondholder. In this case the ratio is the other way. Palmer and the others pay 34½ per cent of the taxes and own 68 per cent of the bonds; hence they receive as bondholders practically two times what they pay as property owners. So, also, they would profit by any increase in the percentage paid. Obviously they would be better off to pay their part of the taxes and receive it back on their bonds if the Town could pay the bonds.

We submit that the answer to the question posed is to not discriminate against property-owning bond-

holders *per se* but to determine whether the plan is fair, in fact, to all bondholders.

Question 2

DOES THE AVON PARK CASE CITED BY THE CIRCUIT OF APPEALS SUPPORT SAID COURT'S CONCLUSION?

The *Avon Park* case, decided by this Court (312 U. S. 138), reversed the lower court, because the Crummer company, the financial agent of the town in handling the composition, was also a creditor of the Town and had three distinct stakes in the plan, of which it did not advise other bondholders when procuring their consents, and which were not taken into consideration in fixing the compensation of said agent for its services. Hence this Court found that the plan lacked the necessary elements of fairness, good faith and full disclosure to other creditors of the interest of the financial agent, who was also a creditor, etc.

None of these elements is presented in the instant case.

The Circuit Court of Appeals also cites its own decision in *Kaufman County vs. Mitchell,* 116 *F.* (2) 959, affirming *Kaufman County Imp. Dist. No.* 4, 34 *F. Supp.* 670. That was a levee district, and the plan of composition proposed to borrow $300,000, $50,000 of which only should be paid in satisfation of its debts at the rate of 8 cents on the dollar; the balance, $250,000, to be spent upon the lands by im-

proving the levees, etc. Obviously the District was not paying all it could, and the property-owning bondholders were getting the advantage, because five-sixths of the loan was being spent to improve their properties. The Court, therefore, held that such property-owning bondholders could not foist the composition upon the minority bondholders, who owned no property. There the facts were examined and the plan was found to be unfair in fact, whereas in the Belleair case the Town proposes to pay all it can, and all bondholders get exactly the same treatment, but the Court rejects it simply because some creditors own property in the Town and others do not. Moreover, there is a fundamental difference between a levee district, which is created for the sole and only purpose of improving lands within its boundaries, and a municipal corporation, which is an agency of the state, created primarily for governmental purposes. The one has no function except to improve lands; the other has no power to improve lands but only to perform governmental and municipal functions, which sometimes incidentally do improve lands.

Question 3

WAS IT ERROR FOR THE CIRCUIT COURT OF APPEALS TO AFFIRM THE JUDGMENT OF THE DISTRICT COURT (ALTHOUGH WITHOUT COMMENTING UPON THIS POINT), WHICH REQUIRED $90,000 BONDS OWNED BY THE TOWN, BUT PLEDGED TO SECURE AN UNPAID BALANCE OF $18,000 LOANED TO THE TOWN TO REDEEM SAID BONDS, TO BE COUNTED IN THE AMOUNT OF THE TOWN'S OUTSTANDING INDEBTEDNESS AND TO BE REFUNDED, ALTHOUGH THE PLAN PROPOSED THAT SAID $18,000 OBLIGATION BE

NOT AFFECTED BY THE PLAN, AND THAT SAID $90,000 BONDS BE CANCELED UPON PAYMENT OF THE $18,000 OBLIGATION, ETC.?

This point relates to the $90,000 Water and Gas Bonds described in Section 3 of the Plan of Composition (R.6). In 1936, after the Supreme Court of Florida held that all the Town's bonds except the Water and Gas Bonds were invalid (*State vs. Town of Belleair,* 170 *So.* 434, 125 *Fla.* 669), the Town had an opportunity to retire said Water and Gas Bonds at a big discount, but it did not have the means to do so. It raised the necessary money by assigning a balance due it by the city of Clearwater for the purchase price of its gas distribution system and borrowing about $35,000 from six persons and pledging the $90,000 Water and Gas Bonds to secure the loan. A trust agreement was made appointing a bank in St. Petersburg escrow agent, and the bonds and agreement were deposited with said bank, which was to receive the payments and distribute the same between the lenders, and finally, when the debt had been fully paid, to surrender the $90,000 Water and Gas Bonds to the town of Belleair (see the agreement, R. 237). At the time the petition in bankruptcy was filed the obligation had been paid down to $18,000, and the plan proposed that the same be not affected by the plan but that the Court order that the $90,000 in Water and Gas Bonds *continue to exist exclusively as security, and when the remaining* $18,000 *had been paid that they be canceled.*

Judge Waller decreed that the said bonds should be counted as a part of the Town's indebtedness and

should be refunded on the same basis as the other bonds, and that the payment made since the petition was filed should be returned. We submit that such disposition would add expense and complication for no good purpose. *The Town does not owe these bonds—it owns them*—and when the remaining $18,000, which they are pledged to secure, shall have been paid the bonds will be retired and actually canceled. To count them as a part of the bonded debt and require that they be refunded is to handle the matter the hard and expensive way and to bring out $27,000 new and live bonds which no one connected with the plan wants, and which will have to be canceled upon payment of the remaining $18,000, or the Town's debt will be enlarged. The bankruptcy law expressly recognizes that all securities and all creditors need not be affected by the plan (Sec. 403 a, b, d, and f, Title 11, USCA). The plan

> ". . . may include provisions modifying or altering the rights of creditors generally, *or of any class of them,*" etc. (Sec. 403 a), and
>
> "The holders of claims for the payment of which *specific property* or revenues are pledged . . . shall accordingly constitute a separate class" (Sec. 403 b).

The $18,000 is abundantly secured if we value the $90,000 Water and Gas Bonds pledged as security at 30 cents, the proposed refunding value of other bonds; hence the $18,000 must be paid in full, according to the contract. The payment upon principal and interest made since the plan was filed is in accordance with the trust agreement, and it should stand; otherwise the Town will have defaulted.

The ratio between the collateral ($90,000) and the present indebtedness ($18,000) is five to one, whereas the refunding plan is based on approximately three to one; hence it is manifestly to the interest of the Town *and of all creditors* that the present plan for the payment continue, and that the bonds be canceled when the obligation has been paid.

Other Reasons Assigned by the District Judge

The District Judge stated two other reasons to support his idea of a differential, namely:

(1) That the property-owning bondholders would receive in new bonds 100 percent of the price they paid in cash for their existing bonds, and "It does not appear what price the non-property-owning . . . bondholders paid for their bonds"; and

(2) ". . . that certain paving certificates or obligations are to be canceled (error *"may"* be canceled, etc., Sec. 1, R. 4-5) under the proposed plan, which is another benefit the property-owning bondholders would likewise receive if that provision of the plan can be effected."

Since the Circuit Court of Appeals did not base its holding on either of these points, we assume that they are not pertinent in considering the petition for certiorari. We, therefore, but briefly suggest that if the price paid for said bonds by the non-property-owning bondholders has any bearing, they had ample opportunity to prove such price and did not. One of them, Mr. Wright, was called to the stand by

the Town and asked what he paid for his bonds; he replied that he did not know (R. 20). The testimony of other witnesses showed that bonds of the Town had been offered in the market for many years at from 9 to 23 cents on the dollar, practically without takers, and the presumption must be indulged that the non-property-owning bondholders acquired their bonds somewhere within that range. Until the consenting bondholders bought at 30 cents under the special circumstances stated in the record, the highest known sale of the bonds of the issues here involved was 20½ (R. 82, 147).

The District Judge's statement that the bonds are to be canceled is not exactly correct. The plan provides

> ". . . that the Town *may adjust or cancel* said special assessments as its governing authority shall deem best, in order to encourage the sale and improvement of properties in said Town and to thereby increase its tax-paying ability" (Sec. 1, R. 5).

The reasons set forth in the plan why it seems expedient that said certificates be adjusted or canceled are that the special assessments are inferior to the liens of State, County, and Municipal taxes accumulated against the property, and that such accumulated State and County tax liens aggregate *"a sum in excess of the value"* of the lots against which the assessment liens exist; that the validity of said assessments is in dispute; that it would cost more to enforce them than could be realized from them; and that to adjust or cancel them would tend to en-

courage the sale and improvement of properties in the Town (R. 5).

The Master found:

> ". . . that the unpaid balances on these assessments are worthless by reason of the fact that the taxes which are prior liens against the same properties are in an amount exceeding the present market value of the properties" (R. 52, par. 14; R. 55, par. 2).

The proposal to adjust or cancel these assessments is authorized by Chapter 21112, Special Acts of 1941 of the Laws of Florida, and accords with the opinion of the Court in *Vallette vs. Vero Beach* (5 *Cir.*), 104 *F.* (2) 59, text on page 64, column 1. In that case the Court approved a similar proposal, holding that the State statute authorizing such adjustment or cancellation was constitutional and valid, and said:

> "It is a practical business matter within the range of a proceeding such as this. The consent of creditors to it is given through the bankruptcy machinery."

We submit that under the facts found by the Master, which the Court approved, no unfairness to any bondholder will result from the adjustment of these so-called assessment liens. Not only are the liens, if they be liens, without value but the Court will not assume that the Town would make an unfair adjustment if such an adjustment should be found possible. The whole matter is discretionary

with the governing authority of the Town, and it must be presumed that such authority will act fairly and honestly.

Respectfully submitted,

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